

**Performance Audit
Review of the Submitted Budget
for Fiscal Year 2006**

March 2005

**City Auditor's Office
City of Kansas City, Missouri**

March 1, 2005

Honorable Mayor and Members of the City Council:

The city's financial condition remains weak – not much better or worse than last year. The city faces long-term problems: inadequate maintenance of capital assets; limited financial flexibility; inadequate fund balance; weak revenue growth; and likely negative effects of weaknesses in the financial conditions of state and federal governments.

The City Manager proposes organizational changes that could save some money and improve the city's ability to provide services. The City Manager plans to consolidate several departments and eliminate some middle management positions. These plans are generally consistent with recommendations we have made in the past. The City Manager may face resistance to change and will need to provide strong leadership, frequent and consistent communication, and training to help reduce resistance to change.

Despite Police Board and City Council policies to add 20 police officers per year between 2003 and 2011 – and increased funding – the Police Department hasn't added officers in the last two years. The Police Department added 20 officers in 2003, but not in 2004 or 2005. Department management didn't clearly communicate the policy implications of their decisions to the Police Board or the City Council. The decision by police management not to fill the additional positions should have been presented as an alternative to the stated Board and City Council policies and debated in a transparent, public forum. The governing bodies, rather than police management, should have made the decision about whether or not to fill the officer positions.

The City Council lacks timely and understandable financial information to make decisions. The City Manager has not presented the financial condition analysis and five-year financial forecast as part of the budget process. The Comprehensive Annual Financial Report has not been completed in a timely manner in the last two years and has yet to be prepared for 2004. The City Manager also has not analyzed development incentives, despite a resolution directing the study.

What can the City Council do to improve the city's financial condition? We recommend carefully monitoring organizational changes, adopting financial policies, and ensuring that the City Manager

analyzes the effects of development incentives, analyzes the city's revenue structure, and presents annual financial reports as part of the budget schedule.

The audit team for this project was Michael Eglinski, Brandon Haynes, Sharon Kingsbury, Amanda Noble, Joyce Patton, Sue Polys, Julia Talauliker, and Vivien Zhi.

Mark Funkhouser
City Auditor

Review of the Submitted Budget for Fiscal Year 2006

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Introduction

Objectives

This performance audit, a review of the City Manager's submitted budget, provides the City Council with information about the city's financial condition and the coming year's budget. We review the submitted budget each year as required by Resolution 911385. This is our 15th budget review.

This year our review focused on the city's overall financial condition, organizational changes recommended by the City Manager, and city funding for infrastructure and police officers.

Scope and Methodology

Our review focuses on the City Manager's submitted budget for 2006. Our methods included:

- Updating financial analysis from prior budget reviews.
- Reviewing prior audit work.
- Reviewing Police Department budgets.
- Interviewing staff from the Police Department and the City Manager's Office.

We conducted this audit in accordance with generally accepted government auditing standards. We omitted no privileged or confidential information from this report.

We discussed the draft report with the Budget Officer and City Manager, but did not ask them to provide a written response to the recommendations.

Findings and Recommendations

Summary

The city's financial condition remains weak. The city continues to face long-term problems: inadequate maintenance of capital assets, low fund balance, limited financial flexibility, and weak revenue growth. The City Manager proposes some organizational changes to save money in this year's budget and in future years. However, the five-year financial forecast projects budget imbalances through 2008 – assuming no new expenditure commitments, which may be difficult to achieve with cuts in federal and state spending likely.

We make several recommendations to help the City Manager and Council improve the city's financial condition and reporting. The City Manager should:

- draft financial policies for City Council deliberation on revenues, debt level and capacity, contingency planning, and balancing the budget;
- present annual financial reports as part of the budget schedule to provide the Council with financial information to support decision-making;
- analyze the effects of development incentives on the city's financial capacity as directed by resolution;
- analyze the city's revenue structure including equity, stability, administrative efficiency, and competitiveness with neighboring jurisdictions; and
- develop outcome measures to monitor progress in addressing infrastructure maintenance.

The City Manager's plan to consolidate several departments and eliminate some middle management positions is consistent with recommendations we have made in the past. The restructuring should provide cost savings and strengthen services that have been fragmented among different functional areas. To manage the risks associated with change, we recommend the City Manager clearly define the roles and responsibilities of departments affected by the consolidation and ensure controls are in place to monitor progress in meeting objectives.

This is the fourth budget in as many years to provide funds to the Police Department for hiring additional officers. The Board of Police Commissioners asked the City Council to fund additional police officers in a resolution in July 2001. The City Council passed a resolution in September 2002 expressing its intent to provide funds for 20 additional officers each year for nine years. While the city has funded 60 additional officers between 2003 and 2005, the Police Department only added 20 officers in 2003 and chose to keep the rest of the new positions vacant in order to fund other priorities. Police management did not clearly communicate to the Board, City Council, and public that its decision was inconsistent with policy and would affect a multi-year plan to reach the staffing goal.

City's Financial Condition Remains Weak

The city's financial condition remains weak as financial flexibility is declining and the proposed budget continues the practice of the past few years of deferring infrastructure maintenance to balance the budget. Projected expenditures continue to outpace projected revenue growth – and the city is likely to face further reductions in assistance from state and federal government. The city's general fund balance remains below the level established by policy. Rebuilding the fund balance will require difficult decisions and significant changes in how the city does business.

City's Financial Flexibility Continues to Decline

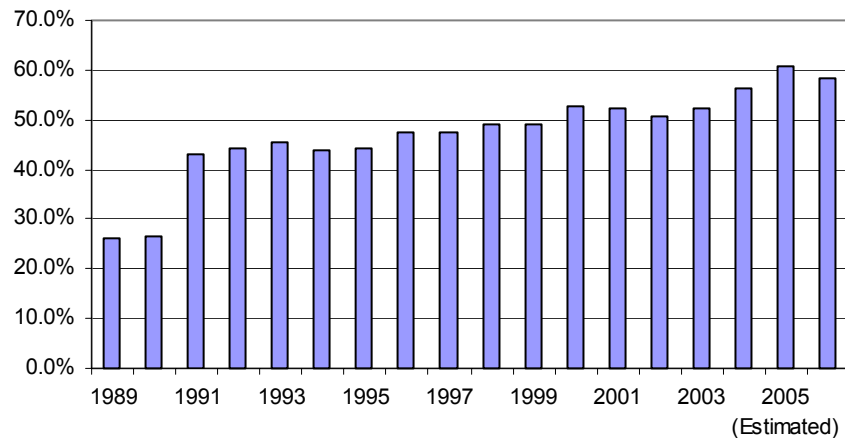
The city's relatively high proportion of restricted revenues and growing fixed expenditures – such as debt service and pension benefits – put pressure on available resources. This reduced flexibility gives the City Council fewer options to respond to changing priorities or unforeseen conditions such as additional funding requirements to fully fund MAST and indigent care or further reductions in funding available from federal and state government.

About 60 percent of the city's operating revenues are restricted.

Restricted revenues are legally earmarked for a specific use by state law, bond covenants, city ordinances, or grant requirements. The higher the percentage of restricted revenues, the less flexibility the City Council has to respond to changing priorities and unforeseen conditions. The city's restricted revenues have been about 60 percent of operating revenues since 1999.¹ (See Exhibit 1.)

¹ Operating revenue is general municipal funds revenue minus debt service and capital maintenance.

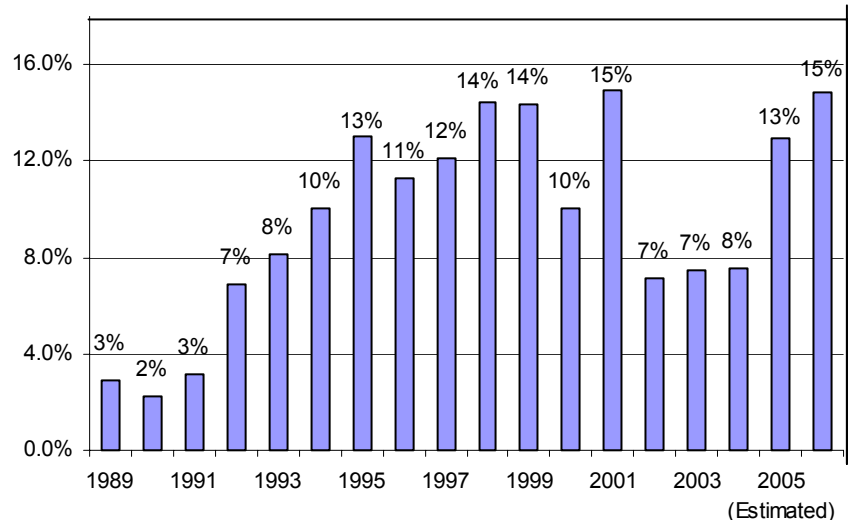
Exhibit 1. Restricted Revenues as Percentage of Operating Revenue



Source Adopted Budgets 1989 – 2005 and Submitted Budget 2006.

Fixed expenditures are growing. Fixed expenditures – such as debt service and pension benefits – are those over which officials have little short-run control. The higher the level of fixed expenditures the fewer options the City Council has to adjust spending in response to economic changes. Debt service is budgeted at 15 percent (\$73.1 million) of operating expenditures in fiscal year 2006, comparable to debt service levels in the mid- to late 1990s.² (See Exhibit 2.) Continuous increases in debt also reduce the city’s capacity to borrow for additional needs.

Exhibit 2. Debt Service as Percentage of Operating Expenditures



Source: Adopted Budgets 1989-2005 and Submitted Budget 2006.

² The increase in debt service expenditures for 2001 is mostly due to refunding \$29 million in Public Safety and Zoo Improvements bonds.

The city is increasing its funding for pension obligations. The budget office's funding plan increases the city's contribution percentage for the city employee and the police civilian employee pension systems as part of a three-year adjustment to offset declining market values. The plan calls for increases of \$1.4 million – to 12 percent of payroll – for the city employee pension system³ and a \$0.5 million increase in funding for the police civilian employee system in fiscal year 2006. Funding for the firefighters' pension and police retirement system as a percentage of payroll will remain the same. The total city contribution to the four pension systems in fiscal year 2004 was about \$35 million. (See Exhibit 3.)

Exhibit 3. City Contributions to Retirement Systems

| Fiscal Year | City Contributions |
|--------------------|---------------------------|
| 2000 | \$25,074,361 |
| 2001 | 26,827,811 |
| 2002 | 29,151,486 |
| 2003 | 31,109,641 |
| 2004 | 34,976,762 |

Source: Actuarial Valuation Reports.

Although the city's employee pension systems remain financially sound and, according to the City Manager, the city will not have to spend a lot restoring the systems to adequate funding levels, the pension contributions will continue to increase as payroll grows.

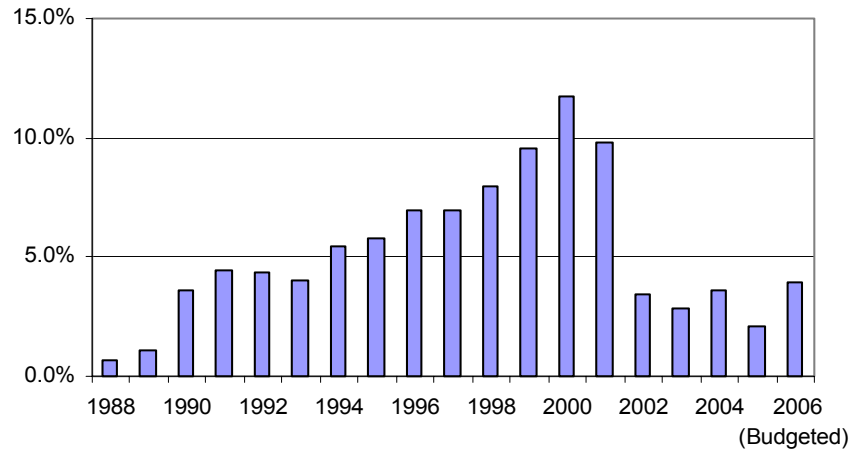
Fund Balance Remains Below Recommended Level

The city's policy is to maintain a general fund balance of 8 percent of general fund expenditures.⁴ The unreserved general fund balance declined to 2.1 percent of expenditures (\$8 million) in 2005, its lowest level in years. The City Manager's proposed budget ends the year with a general fund balance of about 4 percent of expenditures (\$13 million). (See Exhibit 4.) A low fund balance diminishes the city's ability to respond to unanticipated emergencies such as natural disasters and uneven cash flow. The City Manager acknowledged the depletion of the fund reserves and expressed his intent to rebuild the fund balance over the next several years.

³ The increase is for restoring funding to the base system, with funding level at 9.5 percent of payroll. The early retirement window continues to be funded at 2.53 percent of payroll.

⁴ Resolution 980506.

Exhibit 4. General Fund Balance as Percentage of Expenditures



Source: Adopted Budgets 1989-2005 and Submitted Budget 2006.

Revenues Not Keeping Pace with Expenditures, Some Declined

Continuing sluggishness in revenue growth contributes to the budget imbalance. The five-year financial forecast anticipates that about 40 percent of general municipal funds revenues will grow at a rate that is less than or equal to inflation. In addition, telephone utility revenues have declined. While we support the City Manager's effort to restructure the occupational license tax and to improve revenue collection, the city should have a revenue policy and develop strategies for reviewing and improving the city's revenue structure consistent with the policy.

Sluggish revenue growth contributes to imbalance. The budget projects expenditures of general municipal funds to exceed revenues by \$28.2 million in fiscal year 2006 – with estimated revenue growth of only \$10 million (1.9 %). The five-year financial forecast anticipates that between fiscal years 2007 and 2011 at least 40 percent of general fund revenues will grow less than or equal to inflation.⁵

The forecast projects budget imbalances through fiscal year 2008 and relies on limited growth in salaries and benefits to balance revenues and expenditures in fiscal years 2009 and 2010. (See Exhibit 5.) The forecast assumes no new expenditure commitments. Meeting both conditions might be difficult as salary and benefits grew at more than 3 percent in recent years, and future Councils will face pressure to increase spending to meet perceived needs.

⁵ These revenues include utility and motor fuel taxes, business license fees, sales and use taxes, vehicle license fees, cigarette tax, and other property taxes (park district/trafficway assessment and boulevard front tax).

Exhibit 5. Projected Budgetary Imbalances

| Fiscal Year | Imbalance |
|-------------|-----------------|
| 2006 | \$ (20,000,000) |
| 2007 | \$ (13,100,000) |
| 2008 | \$ (4,300,000) |
| 2009 | \$ 2,100,000 |
| 2010 | \$ 6,400,000 |

Source: Submitted Budgets 2005 and 2006.

Telephone utility revenues declined. The city imposes franchise fees on companies that sell telephone services. The fees are based on gross receipts derived from the sale of such services within the city. The rise in wireless and other related services is causing decline in the telephone utility revenue. The city also reduced the rates for residential customers from 9 to 6 percent in recent years, and the budget projects that telephone franchise fees revenues will decline to \$8.3 million in fiscal year 2006, 44 percent less than the \$15 million collected in fiscal year 2000.

The city should review its revenue structure. The City Manager plans to restructure the occupational license tax and take steps to improve the city's overall revenue collection efforts. The City Manager also calls for exploring ways to replace revenue sources that are no longer growing with revenues that would better support the city's needs in the future.

While we support these efforts, the city needs an explicit strategy for periodically reviewing the revenue structure to ensure that it is equitable, stable, efficient to administer, and doesn't result in competitive disadvantages with neighboring cities. We recommend that the City Manager develop a strategy for reviewing and improving the city's revenue structure that will be better able to support the city's needs in the future.

State and Federal Budget Cuts Likely to Negatively Affect Local Government

The federal government is cutting costs from its budget by pushing costs down to other levels of government. The President's proposed budget cuts grants to state and local governments for all programs other than Medicaid by \$10.7 billion – a 4.5 percent decrease from fiscal year 2005 to 2006, after adjusting for inflation.

Despite improvements in the national economy, at least 24 states face fiscal year 2006 budget deficits totaling some \$35 billion, averaging about eight percent of general fund spending in the states with deficits. Cuts in federal grants will make the situation worse. Cuts in state spending may result in less direct funding for local governments or pressure to increase local spending to meet unmet needs.

City Manager Proposes Actions to Improve Services While Limiting Costs

In the 2006 budget, the City Manager proposes actions aimed at improving service delivery to citizens while cutting costs. The plan calls for restructuring or consolidating certain city departments and services beginning in May 2005, as well as eliminating 41 middle management positions. The proposed restructuring could save the city an estimated \$6.5 million per year. These proposals may improve city services by increasing efficiency and improving communication within city departments; however, risks are associated with each proposal if not managed properly.

City Manager Recommends Consolidation and Staff Reduction

The City Manager is proposing to consolidate and restructure 11 departments and services within the city. The 2006 budget would eliminate the departments of Environmental Management, Codes Administration, and Human Relations, and shift their duties to other departments. The budget also would combine services performed by multiple departments, including fleet maintenance, building maintenance, procurement, security and parking operations, creating centralized operations. The City Manager suggests that these consolidations will help improve the delivery of basic services while addressing costs.

The budget also proposes identifying and eliminating middle management positions. The budget estimates that reducing or reclassifying 41 positions could save \$2.9 million. By eliminating these positions, the City Manager hopes to address organizational holes produced by the retirement incentive and past vacancy eliminations.

Consolidations are consistent with prior recommendations. The City Manager's proposals are consistent with what we have recommended in previous audits. We have made specific recommendations to consolidate fleet maintenance, building services, and Human Relations, and to reduce the number of middle management layers. While we did not mention specifically other areas the budget proposes for consolidation, the proposals do follow general concepts of consolidation we have recommended.

Consolidations and staff reductions could save \$6.5 million. The City Manager estimates that these actions could save the city \$6.5 million in the fiscal year 2006 budget. Restructuring and eliminating departments would save the city about \$3.6 million while reducing middle management staff positions could save \$2.9 million.

Consolidation and Staff Reduction Could Improve City Services, Though Some Risks Involved

Consolidating city activities has the potential to allow departments to improve managerial effectiveness and would permit management to identify areas where improvements could be implemented over the entire workload more quickly. It would allow management to save costs by eliminating duplicate services. Other advantages include increased accountability, better targeting of funds, and avoiding high start-up costs for specialized facilities, equipment, and personnel. However, managing the human aspects of changes fostered by consolidation will be a risk for the city. Strong leadership, frequent and consistent communication, and training can help reduce employee resistance to change. The City Manager should define a scope of service for each department affected by consolidation efforts and establish criteria for the types of projects for which they will be responsible.

Reducing management layers and widening span of control provides opportunities for an organization to improve, but not without risks. Professional literature notes potential benefits of improved communication, decision-making, accountability, employee motivation and morale. Communication and decision-making are thought to improve as information passes through fewer layers with increased speed and accuracy. Accountability is clarified as decision-making becomes less diffused. As an organization flattens and widens, improved compensation may also result for remaining employees.

Reductions can be risky for an organization. The elimination of layers often happens abruptly, which creates insecurity among remaining personnel. The insecurity as well as insufficient supervision may result in poor morale and performance errors. Widening span of control and de-layering can be hard on remaining managers due to the increased workload. De-layering may also result in a loss of talented and experienced managers. If the span is too wide, communication becomes difficult. Social networks break down. There is also a tendency for flat organizations to re-inflate. The City Manager should establish controls to ensure a smooth transition of workload between out-going management and those maintained, as well as monitor the effects of management reduction on remaining employees.

Capital Maintenance Further Deferred

The City Manager reduced capital maintenance as one of the ways to balance the budget. The budget decreases funding for infrastructure maintenance by \$4 million. While spending on infrastructure maintenance increased between 2000 and 2004, it was below the appropriated amounts and unspent infrastructure appropriation remains significant. The city needs to continue to improve infrastructure maintenance. Crumbling infrastructure increases the city's costs in the longer term and affects people's perceptions about living and working in the city.

Capital Maintenance Further Deferred

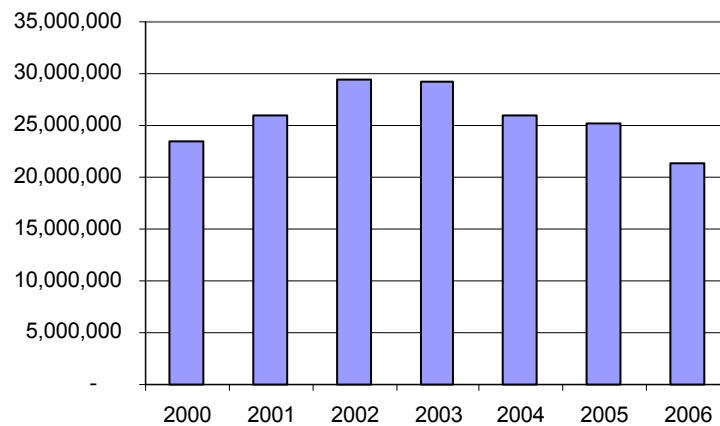
The City Manager's budget transmittal letter describes actions taken to balance the fiscal year 2006 budget, including reducing the amount budgeted for capital maintenance funding by \$6.3 million. This does not comply with the city policy of adding \$5 million annually to fund capital maintenance. The City Council passed a resolution in 1997 to support the Community Infrastructure Committee's recommendation to add \$5 million annually through fiscal year 2006 to fund capital maintenance projects that had been deferred through the years.⁶

Infrastructure Maintenance Budget Decreased

The amounts budgeted for infrastructure maintenance activities – street preservation and marking, municipal building rehabilitation, bridge rehabilitation, traffic signal improvements, and boulevards curbs and walks – have decreased each year since 2002. The proposed budget decreases funding for these activities another \$4 million. (See Exhibit 6.)

⁶ Resolution 971326.

Exhibit 6. Infrastructure Maintenance Budgeted Amount

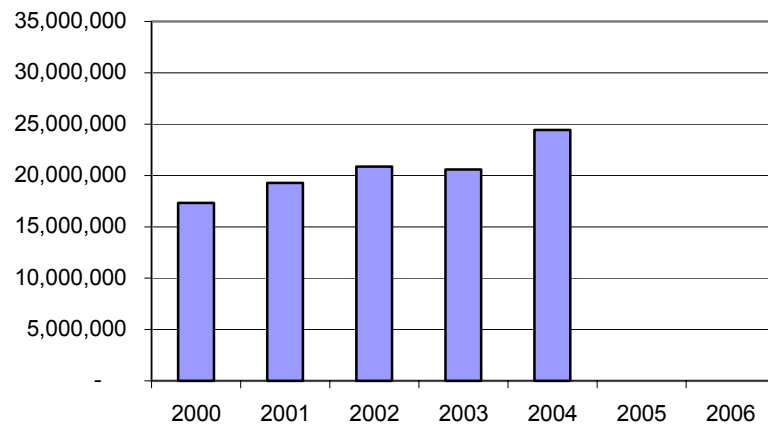


Source: Five-year Capital Improvements Plan, 2000-2005 and Submitted Budget 2006.

While the amount budgeted for infrastructure maintenance decreased in 2004, spending increased as the city spent carryover from prior years. We reported in our January 2005 audit of the Capital Improvements Management Office that the city had a balance of almost \$400 million in unspent appropriations for capital improvements. Unspent appropriations are also significant for infrastructure maintenance, which were about \$28 million at the end of fiscal year 2004.

The city needs to continue efforts to improve infrastructure maintenance. Deferring infrastructure maintenance ultimately costs the city more money because structures can deteriorate to the point where relatively minor repairs become major (or even impossible or impracticable). We haven't estimated the needed level of infrastructure maintenance spending in this report. However, in our March 2002 budget review, we reported that the 2003 budget amount was about half of the approximate \$50 million that was needed. The city should continue to devote more resources to infrastructure maintenance, but should also develop some meaningful outcome measures to monitor the results of increased spending. Debt the city plans to issue in the near future might help the city address infrastructure maintenance needs, depending on how the city uses and manages the debt.

Exhibit 7. Actual Amount Spent on Infrastructure Maintenance



Source: City's Financial Management System.

Despite Policy and Funding, Police Department Did Not Add Officers

The city has budgeted funds for additional police officers each year since 2003 as part of a multi-year plan to address the Police Board's request for increased staffing. However, the Police Department chose not to fill the new positions in 2004 or 2005. Police management did not adequately communicate the effects of this decision to the Police Board or the City Council.

Police Board and City Council Policies Call for More Officers

Both the Board of Police Commissioners and the City Council adopted policies calling for additional officers to improve police protection. The Police Board passed a resolution in July 2001 asking the City Council to fund additional police personnel, citing a need for an additional 130 officers and 15 civilian employees.⁷ The City Council passed a resolution in September 2002, expressing the city's intention to provide funds for 20 additional officers in 2003 and up to 180 officers in the future.⁸

⁷ Police Board Resolution 04-04.

⁸ Resolution 020089.

City Funded 60 Additional Officers through 2005

The City Council appropriated funding each year since 2003 to add 20 officers per year – for a total of 60 by 2005. The City Manager describes the 2006 submitted budget as the fourth in a nine-year commitment to add police officers to reach an additional 180.

Police Department Added 20 Officers in 2003, None in Following Years

The Police Department added 20 officers in 2003, but did not add officers in 2004 or 2005, citing the need to fund other priorities. In a memo dated May 20, 2004, a Deputy Chief reported that the department chose to hold all expenditures constant and not fill 55 police officer positions, which includes 40 funded in response to City Council's policy.⁹ The police shifted funds from salaries to contractual services in order to maintain existing spending levels and pay for increases in health insurance, workers compensation, and self-insurance for liability.

Police management did not clearly communicate to the Police Board, City Council and public, the policy implication of their decision not to add the officers. Police management informed the Police Board that they would hold 55 officer positions vacant, but did not explain to the Board that this decision was inconsistent with the board resolution that expressed need for more officers and would affect a multi-year commitment to reach the staffing goal.

Management is responsible for implementing Board policy. The decision by police management not to fill the additional positions should have been presented as an alternative to the stated Board and City Council policies and debated in a transparent, public forum. The governing bodies, rather than police management, should have made the decision.

Ultimately, the governing bodies might have agreed that management's decision to fund existing programs and expenditures rather than add the officers was appropriate. On the other hand, the governing bodies might have directed management to present alternative spending proposals to cut costs and allow the department to add the officers or might have reduced the department budget to reflect the positions the department intended to fill.

⁹ See the memo in the Appendix.

Council Lacks Financial Information

The City Council needs understandable and timely financial information in order to make informed decisions about the budget. Despite direction from the City Council, the City Manager has not presented a financial condition analysis and five year forecast as part of this year's budget preparation, and has yet to prepare a study on the impact of development incentives on the city's fiscal condition. In addition, the city has not released its Comprehensive Annual Financial Reports (CAFR) in a timely manner in recent years.

The City Manager has not presented financial condition reports.

The City Council defined a budget calendar that requires the City Manager to provide the five-year forecast in October and the financial condition analysis in November. The City Council established the budget calendar by resolution in 1998.¹⁰ The City Manager has not presented these reports this year and didn't last year as part of the budget process.¹¹

Prospective information should play an important role in policy debates and discussions. The City Council needs prospective information, such as 5-year financial forecasts, to make decisions and to understand the potential future effects of their decisions.

The City Manager has not presented a report on development incentives. The City Council passed a resolution, about a year ago, directing the City Manager to provide an annual report on aggregate financial information related to economic development incentives and their impact on the city's fiscal capacity and condition.¹² Because the use of development incentives has increased significantly, it is important to understand the impact on the city's financial condition.

The resolution on studying development incentives is the second time the City Council directed the City Manager to study Tax Increment Financing (TIF) effects and the second time that direction has not worked. In May 1997, the City Council passed a resolution directing the City Manager to study the effects of TIF on the city's revenue stream. The City Manager did not complete that study. The resolution directed the City Manager to report on progress after six months. At the six month point, the Director of Finance recommended not completing the study, partly due to a lack of historical data. The resolution also directed the City Auditor to look at TIF, which we did in a 1998 performance audit.

¹⁰ Resolution 980642.

¹¹ The Budget Officer presented the five-year forecast to the Budget and Audit Committee on February 22, 2005.

¹² Resolution 011726.

Financial reporting is not timely. The amount of time to complete the CAFR has increased. The city used to release the CAFR about six months after the end of the fiscal year, but released the last three years' CAFRs several months later. As of February 25, 301 days from the end of the fiscal year, the CAFR for 2004 has not been released. The most recent CAFR, for the fiscal year that ended ten months ago, has yet to be completed. The annual financial reports provide the City Council, citizens and others with information about the city's financial activity.

Exhibit 8. Days Between End of Fiscal Year and Release of Annual Report

| Fiscal Years | Average days from fiscal year end to CAFR release |
|--------------|---|
| 1980-89 | 131 |
| 1990-99 | 175 |
| 2000-03 | 252 |

Source: 1980-2003 CAFRs.

Adopting Policies Can Strengthen the City's Financial Condition

The city lacks formal financial policies to provide a framework for operational and strategic decision-making. The Government Finance Officers Association (GFOA) recommends cities establish financial policies covering nine areas. The City Council has adopted policies related to three of the areas. Adopting additional policies in areas such as balancing the budget, contingency planning, revenues, and use of debt would increase the City Council's ability to strengthen the city's financial condition.

GFOA Recommends Financial Policies

Financial policies are guidelines for operational and strategic decision making that identify acceptable and unacceptable courses of action and provide standards to assess fiscal performance. GFOA strongly recommends that a government adopt and create formal financial policies in order to promote stability and continuity, standardize response to situations, educate decision makers without background in government financial management, and promote long-term thinking. Bond-rating agencies look favorably upon formal policies. We have recommended adopting GFOA financial policies in years past.

Policies facilitate decision-making and accountability. The City Council is responsible for setting policy. Only secondarily does Council take specific actions in accordance with policy. When making financial decisions on a case-by-case basis, the Council is reacting to situations

rather than planning strategically. The City Council would increase its ability to control the city's financial condition by adopting formal policies and would be better able to hold city staff accountable for its actions.

Don't Financial Policies Limit Flexibility?

There is a choice between flexibility and accountability when designing financial policies. Nonetheless, a government should be able to create a financial policy that provides useful guidance without being overly restrictive. In any event, since financial policies should be subject to annual review, any policy that has proved to be excessively restrictive can be revised at that time.

Source: *Financial Policies: Design & Implementation*, GFOA 2004.

Financial policies strengthen an organization during times of financial difficulty. Organizations are better able to manage financial difficulties when they have set guidelines to control debt, limit spending, and increase revenues. Formal policies that codify the “rules of engagement” enhance the organization's financial health.

City Lacks Financial Policies

The city lacks recommended financial policies. Of the nine policies GFOA recommends, the City Council has established three – policies on stabilization funds, fees and charges, and debt issuance and management.¹³ The city lacks formal policies addressing:

- **Balanced budget** — require structural balance, provide a clear method for achieving balance, identify the sources and uses for all funds, and identify specific circumstances that would allow for deviation from the policy.
- **Use of one-time revenues** — define what one-time revenues will be used for and discourage use of one-time revenues to fund multi-year or ongoing obligations.
- **Use of unpredictable revenues** — identify unpredictable revenues and plan for what to do if these revenues are significantly higher or lower than projected.

¹³ Resolutions 971326, 980506, 990594, 010898, and Section 90, Charter of Kansas City, Missouri.

- **Revenue diversification** — ensure a balanced mix of revenues and periodically analyze the fairness of the different taxes and fees, and their sensitivity to changes in environment or demographics.
- **Debt level and capacity** — identify the maximum amount of debt and debt service that should be outstanding at any one time to maintain capacity to meet future needs and maintain a good credit rating.
- **Contingency planning** — identify the types of emergencies or unexpected events for which the contingency could be used and how to manage the fund.

Although city staff has developed practices to address some of these issues, such informal policies have several shortcomings. Informal policies lack the explicit support of the governing body, tend to be applied inconsistently, and may not stand the test of time as usefulness diminishes with staff turnover.

GFOA recommends staff periodically review policies to keep them relevant, and identify ineffective policies or unintended outcomes. GFOA also recommends that organizations communicate their policies to stakeholders.

The City Council Should Establish Financial Policies

We previously recommended the city adopt formal financial policies. We recommended in our 2001 analysis of the city's budget process that the City Manager prepare a resolution for City Council consideration proposing the adoption of written financial policies. We reported that participants at our 2002 financial condition forum said the city needed a financial vision – where the city wants to be in 10 years – with a set of core financial policies and recommended the city set policies and stick to them. In our review of the submitted budget for fiscal year 2005, we again pointed out that the city lacks adequate financial policies.

The City Manager should direct staff to conduct policy research and submit draft financial policies for City Council consideration. The City Manager should also direct staff to incorporate the city's financial policies into financial documents and to establish a review process to ensure that policies remain relevant.

Method for Developing an Effective Financial Policy

1. Define a situation that a policy is intended to address.
2. Research policy alternatives/solutions. Some of the most valuable resources are financial policies used by other governments. Other sources include GFOA recommended practices and policy research. Typically staff would conduct policy research and draft a policy.
3. Create a draft policy. Whenever practical, a draft policy should include options and outline advantages/disadvantages of each component. A single option offers no alternative if the draft policy is rejected. Discussion of pros and cons will help educate decision makers about the issue and promote buy-in.
 - a. Policies should be concise and not include administrative procedures.
 - b. Jargon and specialized terminology should be avoided.
 - c. Staff should resist constructing a policy that includes every provision that might eventually be desired, as complexity might cause stakeholders to lose enthusiasm.
4. Review of the policy by the affected departments and executive management. Such review would help to ensure mutually agreeable policy options and later a widespread support for the policy. In case of more technical policies that are implemented by the City Manager, the City Manager should find the time to educate the Council about these policies.
5. Review and approval by the City Council.
 - a. Consider limiting the number of policies to be reviewed at one time. If policies are to be reviewed en masse, consider organizing a special workshop.
 - b. Encourage effective communication so dialog takes place and policy objectives are understood.
 - c. Spread credit for creating and adopting the policy across the organization, acknowledge the City Council's role.
 - d. Cite professional standards that advocate policy.
 - e. If the end result does not conform exactly to what the financial officer had envisioned at the outset, consider that it is better to have a policy that the City Council believes in rather than a more technically polished policy that the City Council disregards.
 - f. Publishing policies. The publishing options should be presented to the City Council. There several ways to publish a policy: incorporate into the charter; incorporate into ordinance; pass a board resolution; incorporate into a related document, such as CAFR or the budget.

Source: *Financial Policies: Design & Implementation*, GFOA 2004.

Recommendations

1. The City Manager should develop financial policies for City Council deliberation on revenues, debt level and capacity, contingency planning, balancing the budget, development incentives, and other areas the City Manager considers necessary.
2. The City Manager should present annual financial reports as part of the budget schedule to provide the City Council with information to support decision-making.
3. The City Manager should analyze the effects of development incentives on the city's financial capacity as directed by resolution.
4. The City Manager should analyze the city's revenue structure including equity, stability, administrative efficiency, and competitiveness with neighboring jurisdictions.
5. The City Manager should develop outcome measures to monitor progress in addressing infrastructure maintenance and report on them as part of the budget process.
6. The City Manager should clearly define the roles and responsibilities of departments affected by the consolidation and ensure controls are in place to monitor progress in meeting objectives.

Appendix

Police Memo Regarding 2005 Budget Shortfall

May 20, 2004

EXECUTIVE SERVICES BUREAU MEMORANDUM NO. 04-2**SUBJECT:** Fiscal Year 2004-05 Budget

The Kansas City, Missouri Police Department Appropriated Budget for FY2004-05 totals \$175.8 million from various funding sources, with approximately 92% of the budget supported by revenues from the City of Kansas City, Missouri. This includes \$15.6 million from the Public Safety Sales Tax intended for capital improvement projects. The appropriated amount from general revenues represents slightly less than a 3% or \$3.4 million increase in funding over the previous fiscal year. Although funding from general revenues increased, no new programs were added and health insurance costs were not fully funded. The marginal increase in funding primarily supported pay for existing employees and could not support any new programs or provide for additional police officers.


In actuality, the Police Department faces the daunting task of addressing a projected budget shortfall of approximately \$6.5 million in personnel related expenses alone. This amount includes \$4.0 million in salary savings assessed by the City against the FY2004-05 budget. The salary savings assessment assumes the Police Department will not achieve full employment throughout the year and will maintain around 96% staffing. The shortfall also consists of under funding of programs such as health insurance, life insurance, workers' compensation costs, self-insurance for liability, along with another unspecified cut of \$0.5 million in salaries. In addition to these budget shortfalls, the Police Department will need to be mindful that the City under funded vehicle and radio replacement needs by \$2.5 million.

The Budget Preparation and Control Section personnel have worked diligently to formulate a strategy to address the projected shortfall. However, the mere fact approximately 92% of operating costs are associated with personnel necessitates that the Police Department look to control costs in this area. In order to minimize disruption to services and avoid negatively impacting current employees, the Police Department has chosen not to fill 55 police officer and 25 civilian positions at this time. The 55 police officer positions are composed of 20 additional officers that were to be hired November 1, 2003 and another 20 additional officers to be hired November 1, 2004. The remaining 15 police officer positions will be attained through normal attrition, while the 25 civilian positions are currently vacant. In approximately six months when a budget projection is completed, a determination will be made on what positions need to remain vacant or can be filled.

The FY2004-05 budget does provide full funding supported by general revenues for projected overtime needs. The budget also affords for tuition reimbursements, along with travel and training needs supported by other special revenue funds appropriations. The budget also includes general revenue support for pay step anniversary increases for those members not at top step who have received a satisfactory annual evaluation. Additionally, the Police Department has already supplied preliminary cost estimates to

the City's Office of Management and Budget concerning the fiscal impact of cost of living adjustments for those members at top pay step.

As the fiscal year unfolds, the Police Department will continue to monitor, reassess and fine-tune its fiscal strategies as existing factors dictate. The Kansas City, Missouri Police Department can only achieve its stated goals to prevent crimes, improve relationships and provide excellent customer service if all available resources are used prudently in order to support and equip sufficient personnel to address the needs of the community.



Deputy Chief Kevin Masters
Commander
Executive Services Bureau

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